



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Les White

**SUBJECT: FEBRUARY 22, 2007 STUDY SESSION –
BACKGROUND INFORMATION**

DATE: February 15, 2007

INFORMATION MEMORANDUM

OUTCOME

On February 22, 2007, the City Council will hold a study session on new initiatives and unfunded programs to provide input on the development of the Mayor's March Budget Message for Fiscal Year 2007-2008. To assist in this discussion, the Administration has developed background information to provide context to the many unfunded demands on the City's limited General Fund resources as well as to provide a history of major General Fund reductions experienced over the last five years.

BACKGROUND

At the direction of the Mayor, the annual budget process has been expanded to incorporate additional feedback from the community and City Council on budget priorities. As part of this process, the City Council is holding the February 22, 2007 Study Session on new initiatives and unfunded programs. The Administration has developed the following background information for use during the study session:

1. New and Unfunded General Fund Initiatives/Programs;
2. Unmet/Deferred Infrastructure and Maintenance Needs; and
3. 2002-2003 – 2006-2007 Major General Fund Reductions.

ANALYSIS

In order to provide context to the many unmet demands on City resources, the Administration has prepared a list of the most significant new and unfunded General Fund initiatives currently identified as high priority needs as well as re-issued a previously prepared list of unmet/deferred infrastructure and maintenance needs. In addition, as requested by Vice Mayor Cortese during the November 28, 2006 Budget Study Session, staff has compiled a list of the major General Fund reductions experienced over the last five years. When considering the impact of current unfunded needs and the cumulative impact of prior year reductions, the potential demands on the organization are staggering. These needs are being reviewed and considered at a time when the City is expecting to face, for the sixth year in a row, a General Fund shortfall in 2007-2008. As a reminder, based on the Preliminary 2008-2012 General Fund Forecast that was released in November, the estimated General Fund shortfall for 2007-2008 is \$19.8 million. The Administration will be issuing the final 2008-2012 General Fund Forecast at the end of February. The updated forecast is expected continue to project a funding gap in the General Fund for both the coming fiscal year as well as the four out years of the forecast period.

ANALYSIS (CONT'D.)

New and Unfunded General Fund Initiatives/Programs

As more thoroughly described in Attachment 1, the Administration has identified 13 new and unfunded General Fund initiatives and programs that address Council-generated requests, legal and/or technical requirements, critical needs identified by City staff, and requests made by other entities. These initiatives (summarized in Table 1 below) should not be considered a comprehensive listing of all General Fund needs, but rather a representative sampling of a number of high priority areas recently identified that require additional resources to proceed. The largest items include: the unfunded liability in the City's two retirement systems due to recent Government Accounting Standards Board changes (GASB 43/45) with a price tag of up to \$1.4 billion (\$98 million required on an annual basis); the Police Staffing Plan that identified the need for the addition of 597.5 positions and funding in excess of \$300 million over five years; potential funding gaps in General Obligation Bond Projects that could total up to \$18.2 million under the worst-case scenario; and a shortfall of \$7.9 million to remediate and restore Watson Park. Obviously, given the City's current financial situation, it would not be possible to fully fund these initiatives without significantly impacting and eliminating services provided by the City. It is also true, however, that the City Council will be forced to consider partial or full implementation of some of these items during the upcoming budget process given their critical nature. Any funding of new items, such as those on this list, should, however, be considered for funding only when evaluating potential investments of City resources to ensure that those investments are a higher priority.

Table 1
NEW AND UNFUNDED GENERAL FUND INITIATIVES/PROGRAMS

Unfunded Initiative		Estimated Cost*
1.	GASB 43/45	\$98,000,000
2.	Police Staffing Plan	20,200,000
3.	General Obligation Bond Projects	18,200,000
4.	Watson Park	7,900,000
5.	City-wide Aquatics Plan	7,400,000
6.	Trees-Maintenance and Enforcement	3,850,000
7.	Open Government Initiatives/Reed Reforms	2,000,000
8.	Network Operations Center Back-Up Cooling	1,300,000
9.	Night Shift Custodial Services at City Hall	1,200,000
10.	Shopping Center Improvement Pilot Program	1,200,000
11.	General Plan Update	820,000
12.	Mexican Heritage Plaza	700,000
13.	Small Business Bonding Program	250,000
TOTAL		\$163,020,000

* Represents 2007-2008 costs to fully fund initiative on desired schedule, where possible.

ANALYSIS (CONT'D.)

Unmet/Deferred Infrastructure and Maintenance Needs

A report on unmet/deferred infrastructure and maintenance needs, which is included as Attachment 2, was previously released and discussed at the November 28, 2006 Council Study Session. It has been redistributed to remind us all of the preliminary estimates for the large variety of unfunded infrastructure and maintenance needs for those areas which, if addressed, the General Fund would have to be the sole or partial funding source. The total current needs have been estimated at approximately \$445 million, with an ongoing cost of approximately \$20-25 million. While these preliminary estimates continue to require further analysis, the figures are being provided as a rough indication of the size and breadth of the needs which have accumulated in almost every element of the City's infrastructure. As shown in Table 2 below, the unmet/deferred infrastructure and maintenance needs were broken down into those needs that are completely funded by the General Fund and those needs that have other potential funding sources that could offset a portion of the cost.

**Table 2
 UNMET/DEFERRED INFRASTRUCTURE AND MAINTENANCE NEEDS**

Infrastructure/Maintenance Area	Estimated Cost*
General Fund Needs	
1. Transportation Infrastructure	\$ 391,514,000
2. Information Technology Infrastructure	3,978,000
3. Vehicle/Equipment Replacement	3,025,000
4. General Services Maintenance	1,166,000
Subtotal of General Fund Needs	\$ 399,683,000
Potential Use of Other Funds to Partially Fund	
1. Parks Facilities	\$ 29,664,000
2. General Services Maintenance	11,670,000
3. Convention & Cultural Facilities*	4,290,000
Subtotal Potential Other Funding Sources	\$ 45,624,000
TOTAL	\$ 445,307,000

* Team San José assessment list is not comprehensive.

It should be noted that this analysis does not include the numerous other unmet/deferred infrastructure maintenance needs that exist in the City's various Special Fund programs (e.g., Airport, Water Pollution Control Plant, Sanitary and Storm Sewer Systems, Municipal Water System). Those needs are typically addressed in the capital and operating budgets for those activities. It should be noted, however, that substantial and increased needs have recently been identified for facilities such as the Water Pollution Control Plant and the Storm Sewer System that would require significant rate adjustments to fully fund the needed improvements. For instance, an infrastructure condition assessment prepared this year by a consultant for the Water Pollution Control Plant identified total needs of \$996.8 million, of which \$249.4 million was identified for critical replacements needed for the plant in the first five years.

ANALYSIS (CONT'D.)

2002-2003 – 2006-2007 Major General Fund Reductions

At the November 28, 2006 Study Session, Council Member Cortese requested a more comprehensive compilation of the major General Fund reductions that the City Council has approved over the last five years. The 2002-2003 Adopted Operating Budget was created under very challenging economic circumstances marked by the steepest revenue decline in the City's recent history. The dual impacts of a recession and the events of September 11th dramatically altered the City's fiscal landscape and resulted in significant reductions to public services beginning in 2002-2003 and each fiscal year since. In addition, subsequent to the City adopting its budget for 2003-2004 and 2004-2005, State budget actions were approved that resulted in additional shortfalls that necessitated a rebalancing of the General Fund through additional cutbacks in each of those two years. An inventory of these major General Fund budget reductions for this five-year period is included as Attachment 3 and totals \$69.2 million. This list does not reflect a prioritization of the most critical needs, but rather serves as a reminder of the vital public service reductions that have been injurious to our City that should be considered if any augmentations to the current budget are to be entertained. This inventory, which is organized by City Service Area and program area and displayed in the order of dollar impact (not priority order), includes a description of the expenditure reduction, the impact of the reduction on performance in the service area, and the year in which the reduction occurred. It is important to note that the value of the reductions reflects the costs in the year the reductions occurred and have not been updated for current year values.

Summarized in Table 3 by general category are the Major General Fund Reductions by City Service that have occurred since 2002-2003.

**Table 3
MAJOR GENERAL FUND REDUCTIONS
(2002-2003 through 2006-2007)**

City Service Area	General Fund Reductions*
Neighborhood Services	\$ 27,879,000
Strategic Support	15,390,000
Transportation & Aviation Services	11,675,000
Public Safety	10,343,000
Community and Economic Development	3,353,000
Environmental & Utility Services	609,000
TOTAL	\$69,249,000

* Reduction amounts are based on costs in the year the reduction occurred and have not been updated for current year values.

CONCLUSION

When considering the impacts of the unfunded items and the General Fund reductions experienced over the last several years, it is important to place these needs in context of the City's current fiscal condition. The 2008-2012 Preliminary General Fund Five-Year Forecast that was released in November 2006 estimated a General Fund shortfall of \$19.8 million in 2007-2008. While the Five-Year will be revised and a final forecast released the end of February, it is certain that a General Fund deficit will remain for next year.

As shown in Table 4 below, the cumulative impact of the projected General Fund shortfall for 2007-2008, the new and unfunded initiatives/programs, the unmet/deferred infrastructure and maintenance needs, and the cost of restoring the major General Fund reductions experienced over the last five years totals almost \$700 million. This figure represents over 80% of the base General Fund revenues anticipated for 2007-2008.


Table 4
CUMULATIVE IMPACT OF GENERAL FUND BUDGET SHORTFALL, UNMET NEEDS
AND RECENT MAJOR BUDGET REDUCTIONS

	Funding Impact
2008-2012 Preliminary November General Fund Shortfall	\$ 19,849,000
New and Unfunded General Fund Initiatives/Programs	163,020,000
Unmet/Deferred Infrastructure and Maintenance Needs	445,307,000
Major General Fund Reductions (2002-2003-2006-2007)	69,249,000
TOTAL	\$ 697,425,000

This picture, when these lists are viewed together, is clearly one where not all needs can be met, and a clear indication of the difficulty of the task ahead of us as we jointly decide how to allocate the scarce resources that are available. We will be looking to the City Council for guidance and direction in the months ahead in addressing this challenging task.

COORDINATION

All City Departments, including Council Appointees, have assisted with the preparation of the various documents that are submitted for City Council review.


Les White
City Manager

For questions please contact Larry D. Lisenbee at (408) 535-8144.

NEW AND UNFUNDED GENERAL FUND INITIATIVES/PROGRAMS

1. **GASB 43/45 (Unfunded Liability estimated as high as \$1.4 billion, \$98 million annually)**

Two recent Government Accounting Standards Board (GASB) accounting statements (number 43 and 45) require changes in accounting and external reporting associated with "Other Post Employment Benefits" that are provided by the City, such as retiree health benefits. These changes include identifying the liability for such benefits and disclosing the amounts in annual financial statements. The City's two retirement plans, Federated and Police and Fire, have recently had actuarial studies conducted to calculate the liability under these new accounting standards. Based on the most recent analysis, the unfunded liability could be as high as \$1.435 billion (\$813 million for Police and Fire and \$622 million for Federated), with annual required contributions of over \$98 million (27% of payroll for Police and Fire and 14% of payroll for Federated). A team is working on researching and developing options with the goal of providing additional information to the City Council as part of the upcoming budget process. Options that are being considered by other public sector organizations that have been surveyed in response to the GASB 43/45 requirements include strategies for funding the liability and efforts to mitigate the liability by modifying the retiree health care benefit.

2. **Police Staffing Plan (Estimated cost of \$20.2 million in 2007-2008; \$309 million over 5 years)**

As directed by the City Council in the Mayor's June Budget Message for Fiscal Year 2006-2007, the Police Department developed a five-year staffing plan to address staffing needs for both sworn and non-sworn personnel. This plan, which was presented to the City Council in November 2006, was designed to account comprehensively for existing workload demands and staff shortages experienced by front-line and support personnel throughout the Police Department. The Police Staffing Plan calls for the addition of 597.5 positions phased in over the five year period. In 2007-2008, the cost of this plan is estimated at \$20.2 million and includes the addition of 149.5 positions. Over the five-year period, a total of \$309 million would be expended. After full implementation, the plan would cost \$121 million annually.

3. **General Obligation Bond Projects (Potential cost of \$18.2 million based on worst-case scenario project cost estimates)**

In January 2007, a status report on the overall funding for the City's General Obligation Bond projects for parks, libraries, and public safety facilities was brought forward for City Council review. The recent volatility in construction and real estate costs has raised concerns about the overall outlook for completion of the remaining bond projects. Staff developed a worst case cost escalation scenario that would result in a shortfall of \$18.2 million in the Library (\$5.1 million), Parks (\$6.3 million), and Public Safety (\$6.8 million) Bond projects. Potential options to address shortfalls include reducing project scopes, using other funding sources such as Construction and Conveyance Tax and Redevelopment Agency funds, and identifying Bond projects as a priority when seeking federal and State grants. It should be noted that the bond projects that have not yet been completed will result in significant additional operating and maintenance costs estimated at \$324,000 in 2007-2008 and increasing to \$17.5 million by 2011-2012. These costs have been factored into the 2008-2012 Preliminary General Fund Forecast.

NEW AND UNFUNDED GENERAL FUND INITIATIVES/PROGRAMS**4. Watson Park (Estimated cost of \$7.9 million)**

Watson Park is a 35-acre park located approximately two miles northeast of downtown San José. In June 2004, contractors encountered debris consistent with a burn dump site during excavation for the construction of a skate park at Watson Park. The construction project was halted and the park was fenced off and closed to the public. Testing of the park site and adjacent properties on Terrace Drive confirmed the presence of burn ash and dump debris from an incinerator that had operated on this site for approximately 20 years starting around 1914. The preliminary estimate of the cost of remediation and restoration of Watson Park is \$15.4 million. Of this amount, \$7.5 million has already been funded. It is necessary to identify an additional \$7.9 million to complete the remediation work and the park restoration project. Staff is exploring the availability of other funding sources to partially offset the cost of this project.

5. City-Wide Aquatics Plan (Estimate cost of \$7.4 million to implement short-term strategy)

The Department of Parks, Recreation and Neighborhood Services (PRNS) has been working with a consultant to develop a city-wide Aquatics Master Plan. Through the master plan process, PRNS sought the opportunity to reach out to its customers, to re-examine its service delivery system, and to make informed decisions on how best to maximize the return on investment in the Aquatics program. The status report on this master plan, which is scheduled to be presented to the City Council on February 27, 2007, presents a variety of scenarios to address the aquatics needs of the City. These options ranged in price from a low of \$5 million to repair existing facilities to a high of \$169 million for a significantly expanded city-wide aquatics program that would add several new facilities throughout the City. The status report also identified short, mid, and long-term strategies for the City's Aquatic Program. The short-term strategy, which covers a five-year period, includes the renovation of the Mayfair and Biebrach pools, funding for a total of seven leased sites, studies for the mid-term projects, and a community process with the Alviso community to determine an appropriate re-use of the pool site. The estimated cost of the short-term strategy is \$7.4 million. Potential funding sources for this phase include new and existing Parks Construction and Conveyance Tax Funds and the Park Trust Fund.

6. Trees – Maintenance and Enforcement (Estimated cost of \$3.85 million)

The City Council has recently expressed interest in improving tree maintenance and enforcement. Staff has estimated that approximately \$3.85 million would be needed annually to maintain trees (\$3.6 million) and to enforce the City's Municipal Code related to tree removal (\$250,000). This level of tree maintenance funding would allow for structural tree pruning of the approximately 300,000 street trees every 8 years; the administration of both public and private property (non-development related) tree permits; the development and maintenance of a street tree inventory; the posting of all tree permits accessible on the internet for rapid verification by the Police Department, Code Enforcement, and neighbors; and replacement of 500 to 1,000 street trees annually. The addition of two Code Enforcement inspectors would also be necessary to enforce the City's Municipal Code related to tree removal controls for business and property owners and other weekend-related enforcement activities.

NEW AND UNFUNDED GENERAL FUND INITIATIVES/PROGRAMS

7. **Open Government Initiatives and Reed Reforms (Estimated cost of \$1–\$2 million)**

The Open Government initiatives (Sunshine Reforms) and the implementation of the Reed Reforms will require additional City resources. To fully implement the Sunshine Ordinance, additional staff support will likely be necessary in the Offices of the City Manager, City Clerk, and City Attorney as well as the Information Technology Department. In addition, one-time funding for various technology improvements would be required to provide the necessary infrastructure (City website evaluation, expanding electronic storage, Public Records Management Program). Additions in the City Auditor's Office were also recommended as part of the Reed Reforms (Reed Reform #34 – expand the City Auditor's staff to allow for more performance audits). Preliminary costs are estimated between \$1–\$2 million to implement the current set of Sunshine Reforms and other Reed Reforms now under review. The actual costs will be determined after Council adoption of the final set of actions related to this issue.

8. **Dedicated Back-up Cooling of the Network Operations Center (Estimated cost of \$1.3 million)**

The Network Operations Center (NOC) at City Hall is required to be kept at approximately 68 degrees in order to protect the city's computer network and telephone equipment it contains. In the event that the City Hall primary air-cooling system fails to operate, a back-up air-cooling system dedicated to the NOC is needed. This system would provide emergency cooling of the Network Operations Center space so as to maintain network operations and protect all server and telephone equipment.

9. **Night-Shift Custodial Services at City Hall – MEF Interest in Contracting-in (Estimated cost of \$1.2 million)**

The Municipal Employees' Federation (MEF) has expressed interest in contracting-in the night shift custodial services provided at City Hall. It is estimated that this change would require the addition of 27 positions, including 21 Custodians, 4 Senior Custodians, and 2 Custodial Supervisors at a cost of \$1.8 million, partially offset by a \$635,000 reduction in existing custodial contractual services. These costs would not result in a change to current levels of service.

10. **Shopping Center Improvement Pilot Program (Estimated cost of \$1.2 million)**

Throughout San José, aging and under-improved strip malls may diminish the perceived value of adjacent neighborhoods. The impacts of under-investment in these properties are significant and contribute to an appearance of neighborhood decline; reduced visibility for local retailers, which decreases economic performance; potential deterrence of new retailers; and a loss of local revenue (sales tax) from residents pursuing more inviting shopping experiences elsewhere. To address these concerns, the Office of Economic Development (OED), in conjunction with the Redevelopment Agency and the Planning, Building and Code Enforcement Department, would like to implement a Shopping Center Improvement Pilot Program modeled after the Redevelopment Agency's successful Façade Improvement Program. The Pilot Program would provide grant funds to enhance the overall appearance of the selected shopping center(s) through façade and landscape improvements. Staff is pursuing federal funds as part of the Community Development Block Grant program (\$300,000) and using \$220,000 from an existing General Fund allocation to fund a portion of this \$1.2 million program.

NEW AND UNFUNDED GENERAL FUND INITIATIVES/PROGRAMS**11. General Plan Update (Estimated cost of \$820,000 in 2007-2008; \$2.04 million over 3 years)**

Funding is necessary to update the City's General Plan, as directed in the Mayor's Revised June Budget Message for 2006-2007. The last comprehensive update of San José's General Plan was adopted in 1994. The City is facing significant growth issues and the General Plan is traditionally updated every ten years. The General Plan update would allow the City Council and the City staff to engage the community in preparing a land use vision to direct future growth while preserving the quality of life in neighborhoods. The cost to complete a comprehensive General Plan Update was included as a Committed Addition in the 2008-2012 General Fund Forecast that was issued in November 2006. This included \$820,000 in 2007-2008, \$840,000 in 2008-2009, and \$380,000 in 2009-2010 for a total cost of \$2.04 million.

12. Mexican Heritage Plaza (Estimated cost of \$700,000)

The Mexican Heritage Corporation has requested a \$700,000 increase in its operating subsidy from \$413,000 to \$1.1 million. Per City Council direction, no action on this request will be brought forward until the City Auditor completes an audit of this facility. It is currently anticipated that this audit will be completed and presented to the Rules Committee at the end of February or the beginning of March 2007.

13. Small Business Bonding Program (Estimated cost of \$250,000)

The Small Business Development Commission requested that the City consider creating a surety bond program that would assist small contractors on qualifying to bid on City construction projects. This would assist small contractors that are interested in bidding on City projects but are hindered in doing so because of their inability to obtain the requisite surety bonds. Two alternatives are being reviewed. One is for the City to establish a self-insured surety bond pool. The second is to establish a bonding and financing assistance program with the help of a qualified consultant. For either scenario it is estimated that \$250,000 would be needed to fund the development and implementation of a city-wide program to assist small local and disadvantaged contractors and subcontractors in qualifying for surety bonds. Details of both alternatives will be presented to the Small Business Development Commission on March 14th.